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As access to alts expands, here's why some advisors remain cautious
By Rob Burgess
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Access to alternative investments and private markets has been increasing in recent years, a trend that is expected to continue.

One of many recent indications of that came last week as Envestnet, via partnerships with asset managers BlackRock, Fidelity Investments, Franklin Templeton and State Street, began offering professionally managed model portfolios with semiliquid alternative allocations and alternative ETFs in its unified managed account platform.

Over the past five years, Mike Anderson, a financial planner with AdviceOnly in San Diego, said he has observed a surge in client interest in alternative investments and private placements, particularly in commercial real estate, as a means to diversify portfolios.

"These options are increasingly viewed as viable strategies for managing market volatility and inflation risks without the burdens of direct property ownership," he said.

But such assets come with due diligence needs significantly different from traditional investments. Evan Luongo, financial advisor and founder of NoDa Wealth Management in Charlotte, North Carolina, said he spent the better part of a decade educating financial professionals on why not to invest in most alternatives and private investments. He said his concerns are that they're expensive, the performance often doesn't justify the hype, most investors don't fully understand them, they hide volatility and the money is often locked up.

"This doesn't mean private investments are always the wrong move, but they require a higher level of scrutiny and a clear understanding of how they fit into the bigger picture," he said.

Still, some advisors see alts as key to portfolio management. Private markets will play an increasingly central role in wealth management over the next decade as more companies remain private for longer, said Zoltan Pongracz, co-founder of Third View Private Wealth in Westport, Connecticut.

"Access to these opportunities becomes essential for clients seeking differentiated returns and meaningful diversification," he said. "Alternative investments won't be alternative anymore but rather a standard part of a portfolio for the average investor. Secondaries will be the next boom. As private markets allocations increase, so too will the need for dynamic liquidity."

Technology platforms like CAIS, lower investment minimums and more investor-friendly fund structures are also helping to make private strategies more available, said Pongracz. But this increased access is a double-edged sword, he said.

"It's more important than ever to understand how these strategies fit into a client's overall plan and just as importantly, which ones to avoid," he said.

Private markets and alternative investments can add meaningful diversification and growth potential to a portfolio, but they demand a disciplined, almost skeptical, evaluation process, said Michael Becker, partner at Toberman Becker Wealth in St. Louis.

"These opportunities often come with unique risks, such as illiquidity, higher fees and opacity in performance data, which means they aren't suitable for everyone," he said. "When I consider these investments for a client, I focus first on ensuring the core of their portfolio — public markets — is well built and stable. Only then does it make sense to explore alternatives."

Alts are right for some, but not everyone

Access to private assets is expanding but not necessarily for the right reasons, said Mike Wallberg, principal and head of marketing and communications at Leith Wheeler Investment Counsel in Vancouver, British Columbia, Canada. (He is also the host of the CFA Institute's investment podcast, "Enterprising Investor.")

"Individual investors want access to institutional strategies, but their circumstances are not necessarily suited to them," he said. "Wall Street is happy to supply the demand for high-fee, sticky assets, but the parabolic increase in private asset funds follows a familiar pattern in which the 'hot money' has been made and retail investors end up chasing yesterday's returns. All the demand for private assets can only pressure prices higher for them, impairing the future performance of those funds."

Alts can play a constructive role in a well-diversified portfolio for the right investor, but they are not for everyone, Wallberg said. He is not a believer in the push to "democratize" access to alternatives because the liquidity risk the average mass affluent investor can bear is far lower than that of institutions or even high net worth clients.

"Our HNW clients tend to allocate less than 20% to alts, but we're seeing peers locking 50% or more of their clients' assets up in alts," he said. "This approach seems irresponsible to me, and likely to end in tears."

Be especially cautious with alts in retirement planning

The S&P 500 has become more concentrated, and private markets are a great way to diversify in noncorrelated assets, said Brennan Decima, owner of Decima Wealth Consulting in St. Petersburg, Florida. However, they should never be the

core of a retirement strategy, he said.

"For many of my clients heading into retirement, the focus shifts from chasing growth to protecting income and principal," he said. "Oftentimes when I ask clients why they have an alternative in their strategy, it is because a former advisor raved about the performance potential it had. Taking on too much risk, or having too little flexibility can quickly derail a good plan. I look at private investments the same way I use spices. A pinch of the right thing can enhance the recipe, but too much of anything will overwhelm the whole dish."

Retirees need to be cautious with alternative investments, said Decima. These strategies often lock up money for years, come with complex fee structures and offer paper returns that don't fund real-life expenses, he said.

"In retirement, your investments should provide income, flexibility and peace of mind. Peace of mind starts with understanding," he said. "Advisors have a massive responsibility on their plate to understand all of these new products and whether or not they can simplify their objective to the client. If it's not simple, liquid and transparent, it probably doesn't belong in most people's retirement plans."

How to evaluate alternative investments

Alternative or private assets are not a single asset class as they include real estate, infrastructure, hedge funds, private debt, private equity and more. Each class has unique characteristics that must be understood before investing, said Wallberg. When assessing investment quality, he looks at the track record of the management team and their compensation structure to ensure they're aligned with the goals, and importantly, the fees.

"Fees are higher across the board for private assets relative to plan-vanilla public ones, and some structures can stack fees on fees if you're not careful," he said. "The corrosive effect of high fees on returns will compound over time so it's important to ensure you're not overpaying."

When evaluating alts, Decima said initial questions should include: Who are the people behind the fund? Do they have a repeatable investment process? Are the fees and terms fair to the investor?

Becker said he advises clients to avoid chasing exclusivity. Just because an investment sounds unique or hard to access doesn't automatically make it better or aligned with set goals.

"I expect access to private markets to continue expanding, particularly as technology reduces entry barriers," he said. "The key will be for investors to maintain their critical lens rather than getting swept up in the hype of accessibility. As private markets expand and their barriers to entry decrease, I expect the historical liquidity premium to also decrease."